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City and County of San Francisco

Office of the Controller – City Services Auditor

BOARD OF SUPERVISORS:

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**CONTROLLER'S OFFICE
CITY SERVICES AUDITOR**

The City Services Auditor was created within the Controller's Office through an amendment to the City Charter that was approved by voters in November 2003. Under Appendix F to the City Charter, the City Services Auditor has broad authority for:

- Reporting on the level and effectiveness of San Francisco's public services and benchmarking the city to other public agencies and jurisdictions.
- Conducting financial and performance audits of city departments, contractors, and functions to assess efficiency and effectiveness of processes and services.
- Operating a whistleblower hotline and website and investigating reports of waste, fraud, and abuse of city resources.
- Ensuring the financial integrity and improving the overall performance and efficiency of city government.

The audits unit conducts financial audits, attestation engagements, and performance audits. Financial audits address the financial integrity of both city departments and contractors and provide reasonable assurance about whether financial statements are presented fairly in all material aspects in conformity with generally accepted accounting principles. Attestation engagements examine, review, or perform procedures on a broad range of subjects such as internal controls; compliance with requirements of specified laws, regulations, rules, contracts, or grants; and the reliability of performance measures. Performance audits focus primarily on assessment of city services and processes, providing recommendations to improve department operations.

We conduct our audits in accordance with the Government Auditing Standards published by the U.S. Government Accountability Office (GAO). These standards require:

- Independence of audit staff and the audit organization.
- Objectivity of the auditors performing the work.
- Competent staff, including continuing professional education.
- Quality control procedures to provide reasonable assurance of compliance with the auditing standards.

Audit Team: Helen Storrs, Audit Manager
Renato Lim, Associate Auditor



CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

Ben Rosenfield
Controller

Monique Zmuda
Deputy Controller

October 29, 2009

Board of Supervisors
City and County of San Francisco
City Hall, Room 244
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

President and Members:

The Controller's Office, City Services Auditor, presents its report concerning the review of franchise fee payments Pacific Gas and Electric Company (PG&E) made to the City and County of San Francisco (City) to use its streets to transmit, distribute, and supply electricity and gas within the City. PG&E is required to report its gross receipts and pay each year a total of 0.5 percent of its gross receipts for the sale of electricity and 1 percent of its gross receipts on the sale of gas. PG&E collected electricity and gas surcharge fees pursuant to requirements in the California Public Utilities Code, and remitted those amounts to the City when PG&E paid its franchise fees.

Reporting Period: January 1, 2006, through December 31, 2008

Fees Paid:	Franchise Fees	\$ 17,772,975
	Surcharge Fees	2,606,600
	Additional Franchise Fees	<u>52,639</u>
	Total	\$ 20,432,214

Results:

PG&E submitted its franchise fees to the City on a timely basis, and correctly collected and remitted electricity and gas franchise surcharge fees to the City. PG&E also disclosed and paid additional franchise fees due totaling \$86,368 for calendar years 2005 through 2007. PG&E included the additional amounts with the annual remittances for 2007 and 2008, instead of remitting them earlier.

The responses of the San Francisco Public Utilities Commission (SFPUC) and PG&E are attached to this report. The Controller's Office, City Services Auditor will work with the SFPUC to follow up on the status of the recommendations made in this report.

Respectfully submitted,

Tonia Lediju
Director of Audits

cc: Mayor
Board of Supervisors
Budget Analyst
Civil Grand Jury
Public Library

INTRODUCTION

Audit Authority

The Office of the Controller (Controller) is required under the San Francisco Administrative Code, Chapter 11, Article 5, Section 11.44(a) to file a report with the Board of Supervisors analyzing whether each person owing a franchise fee is complying with the audit, reporting requirements, and payment obligations contained in the Chapter and any franchise, no less than every two years. In addition, the City Charter provides the Controller, City Services Auditor (CSA), with broad authority to conduct audits.

Background

In 1939, the City and County of San Francisco (City) granted Pacific Gas and Electric Company (PG&E) and its successors two franchises to use City streets to transmit, distribute, and supply electricity and gas. In consideration for the two franchises, PG&E agreed to pay the City annually a percentage of its gross receipts from the sales of electricity and gas in the City.

The electricity and gas franchise ordinances require PG&E to remit to the City, by April 15 of each year, a total of 0.5 percent of PG&E's gross receipts on the sales of electricity and 1 percent of PG&E's gross receipts on the sales of gas. In reporting the gross receipts subject to the City's franchise fees, PG&E deducts from its total revenues such amounts as uncollectible accounts and interdepartmental sales. Interdepartmental sales include the amounts recorded by PG&E for supplying electricity and gas to other PG&E departments within San Francisco.

PG&E collects electricity and gas surcharge fees pursuant to requirements in the California Public Utilities Code and remits those amounts to the City when it pays its franchise fees. PG&E collects the surcharge fee, which is a municipal surcharge for the use of public lands, from customers who purchase electricity and gas from a third party. The surcharge fee is to replace, but not to increase, franchise fees that would have been collected if not for changes in the regulatory environment such as the unbundling of the gas industry. PG&E started collecting and remitting surcharge fees for gas in 1994 and for electricity in 1998.

Additionally, PG&E has an Interconnection Agreement with the City to transmit electricity generated by the Hetch Hetchy project (Hetch Hetchy) inside and outside the City, distribute that electricity within the City, and sell supplemental power to the City. PG&E bills the City for services, including transmission and distribution charges, supplemental power charges, demand charges, and other special charges. PG&E includes the transactions for services it provides to the City as part of PG&E's gross receipts from the sales of electricity reported to the City.

The San Francisco Public Utilities Commission (SFPUC) is responsible for administering the Interconnection Agreement with PG&E. Administration includes verifying the accuracy of monthly billings prior to payment.

Scope and Methodology

The purpose of this audit was to determine whether PG&E correctly reported its gross receipts and timely paid to the City the correct franchise fees and surcharge fees under the terms of the electricity and gas franchise ordinances.

The audit covered the period January 1, 2006, through December 31, 2008.

To conduct the audit, the audit team:

- Reviewed the applicable provisions of the franchise ordinances and tested, on a sample basis, selected PG&E revenue components with amounts that materially impact the franchise fees payable to the City.
- Interviewed staff from PG&E and SFPUC to aid in documenting and testing PG&E's revenues.

To determine whether PG&E correctly reported its annual gross receipts, the audit team:

- Compared the amounts PG&E reported to the City to the amounts PG&E recorded in its monthly summary reports and monthly detailed reports.
- Tested the reasonableness of electricity and gas surcharge fees collected by PG&E.

The audit team limited the review of the revenues recognized from the Interconnection Agreement to tracing the amounts reported by PG&E to its monthly summary reports. The audit team did not test the accuracy of the detailed Interconnection Agreement billings because SFPUC staff is responsible for reviewing the billings to ensure they are accurate before paying PG&E.

This performance audit was conducted in accordance with generally accepted government auditing standards. Those standards require planning and performing the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. We believe that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

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AUDIT RESULTS

PG&E Submitted Its Gross Receipts Reports and Paid Associated Franchise Fees on Time

For the audit period January 1, 2006, through December 31, 2008, Pacific Gas and Electric Company reported \$2,739,018,279 in electricity and gas sales within the City, and paid \$17,825,614 in franchise fees. PG&E correctly collected and remitted to the City electricity and gas surcharge fees of \$2,606,600 for the period under review.

EXHIBIT Gross Receipts Reported and Franchise Fees and Surcharge Fees Paid January 1, 2006, Through December 31, 2008

Reporting Period	Gross Receipts (1)	Franchise Fees (2)	Surcharge Fees (3)
<u>January 1, through December 31, 2006</u>			
Electricity	\$ 620,298,589	\$ 3,101,493	\$ 200,678
Gas	270,021,995	2,700,220	622,579
<u>January 1, through December 31, 2007</u>			
Electricity	654,380,460	3,271,902	227,011
Gas	259,086,527	2,590,865	569,562
<u>January 1, through December 31, 2008</u>			
Electricity	648,762,553	3,243,813	201,332
Gas	286,468,155	2,864,682	785,438
Additional Electricity (4)		52,639	-
Total	\$2,739,018,279	\$ 17,825,614	\$ 2,606,600

1: Gross receipts reported by PG&E are net of uncollectable accounts and interdepartmental sales.

2: Franchise fee rates are 0.5 percent of electricity receipts and 1 percent of gas receipts.

3: PG&E billed and collected electricity and gas franchise surcharge fees based on the formula specified in state law from its customers who purchased electricity and gas from a third party

4: The additional electricity franchise fee payment is the result of \$9,237,722 of gross receipts for services provided under the Hetch Hetchy Interconnection Agreement which were identified in January 2009 for January 1, 2005, through December 31, 2007. These additional receipts were the result of a change in PG&E methodology for allocating Hetch Hetchy Interconnection Agreement service revenues.

Sources: PG&E Certification of Gross Receipts and Hetch Hetchy Interconnection Agreement service revenue retroactive adjustment supporting documentation.

**A Change in Hetch
Hetchy Revenue
Allocation Resulted in
Additional Gross
Receipts Subject to
Franchise Fees**

In January 2009, PG&E made a change to its methodology of allocating gross receipts for services provided to the City under the Interconnection Agreement with the SFPUC. Of its own accord, PG&E recalculated, for the period 2005 through 2007, the amount of gross receipts and corresponding franchise fees due to the City. The recalculation resulted in an additional \$9,237,722 in reported gross electricity receipts within San Francisco and an additional \$52,639 in franchise fees due, including 7 percent interest. The audit found that PG&E's revised allocation methodology was adequate, and the additional reported gross electricity receipts and franchise fee amounts were accurate. However, other than including support for the recalculation and the additional payment in the 2008 franchise fee certification submitted with its payment, PG&E did not notify the City upon discovery of the matter. As a result the City had no involvement in the resolution of the matter, such as determining how far back PG&E should have applied the change in the allocation methodology. San Francisco Administrative Code Chapter 11, Article 2, Section 11.26 requires that, in the event of any good faith dispute between a person owing franchise fees and the City regarding the amount of franchise fees owed the City, the person alleged to owe the franchise fees shall place the amount in dispute in an escrow fund from which the franchise fees, plus interest at the rate of the City's pooled funds, shall be paid to the appropriate party, once the dispute is resolved.

**PG&E Underreported
2006 Gross Receipts and
Included the Amounts in
the 2007 Franchise Fee
Report**

In 2007, PG&E realized that it did not report \$6,545,746 of gross electricity receipts in its 2006 franchise fees certification because of a change in the database system it uses to prepare the certification. Of its own accord, PG&E added the 2006 underreported amount in its 2007 franchise fees certification. The end result was that 2006 gross receipts were underreported, and 2006 franchise fees were underpaid by \$32,729. In addition, the 2007 gross receipts were over reported and the 2007 franchise fees were overpaid by the same amount. PG&E did not notify the City upon discovery of this matter. However, PG&E did include these receipts and corresponding franchise fees in the 2007 certification. Furthermore, the City had no involvement in the resolution of this matter, including whether PG&E should have filed an amended franchise fee certification for 2006, instead of adding the underreported amount in question on its 2007 franchise fees certification.

**San Francisco Public
Utilities Commission Did
Not Issue Its Statutorily
Required Franchise
Compliance Report**

The San Francisco Public Utilities Commission (SFPUC) is required by San Francisco Administrative Code, Chapter 11, Article 5, Section 11.44(b) to file a report with the Board of Supervisors (Board) analyzing whether each franchise grantee is complying with all provisions of this chapter and its franchise, except for those addressed by the Controller's Report,¹ not less than every two years. The audit found that SFPUC has not complied with this statutory requirement.

Recommendations

The San Francisco Public Utilities Commission should take the following actions:

1. Consult with the City Attorney's Office to determine if PG&E needs to apply the Hetch Hetchy Interconnection Agreement service revenue allocation methodology change to receipts reported prior to 2005. If determined that the methodology change is applicable to years prior to 2005, the SFPUC should ensure that applicable franchise fees, plus interest, are collected from PG&E.
2. Remind PG&E to promptly remit any additional franchise fees discovered to be due.
3. Comply with its statutory requirement to file a report with the Board analyzing whether each franchise grantee is complying with all provisions of Chapter 11 of the San Francisco Administrative Code and its franchise, except for those addressed by the Controller's Report, not less than every two years.

¹ Controller's Report refers to the report requirement under San Francisco Administrative Code, Chapter 11, Article 5, Section 11.44(a) analyzing whether each person owing a franchise fee is complying with the audit, reporting requirements, and payment obligations contained in the Chapter.

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ATTACHMENT A: SFPUC'S RESPONSE



SAN FRANCISCO PUBLIC UTILITIES COMMISSION

POWER ENTERPRISE

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October 1, 2009

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MAYOR

F.X. CROWLEY
PRESIDENT

FRANCESCA VIETOR
VICE PRESIDENT

ANN MOLLER GAEN
COMMISSIONER

JULIE ELLIS
COMMISSIONER

ANSON B. MORAN
COMMISSIONER

ED HARRINGTON
GENERAL MANAGER

Tonia Lediju, Director of Audits
Controller's Office
City Hall, Room 476
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Dear Ms. Lediju:

The San Francisco Public Utilities Commission (SFPUC) has reviewed the Franchise Fee Audit of Pacific Gas & Electric Company (PG&E), prepared by Controller's Office, City Services Auditor, for the period of January 1, 2006 through December 31, 2008.

The SFPUC concurs with the Audit findings and recommendations and will work with the appropriate parties, including PG&E, to ensure that any changes to the Interconnection Agreement (IA) are communicated as they may affect the revenue allocation methodology associated with the Franchise Fees.

Sincerely,

Camron Samii
San Francisco Public Utilities Commission
Manager, Strategic & Resource Planning, Power Enterprise

cc: Helen Storrs, Audit Manager, Controller's Office
Barbara Hale, Assistant General Manager, Power Enterprise

Recommendation	Responsible Agency	Response
1. Consult with the City Attorney's Office to determine if PG&E needs to apply the Hetch Hetchy revenue allocation methodology change to receipts reported prior to 2005. If determined the methodology change is applicable to years prior to 2005, the SFPUC should ensure that applicable franchise fees, plus interest, are collected from PG&E.	SFPUC	The SFPUC will review the revenue allocation to determine if any action(s) are necessary for receipts reported prior to 2005 and going forward.
2. Remind PG&E to promptly remit any additional franchise fees discovered to be due.	SFPUC	The SFPUC will establish a process to notify and remind PG&E to incorporate any changes to the franchise fees.
3. Comply with its statutory requirement to file a report with the Board analyzing whether each franchise grantee is complying with all provisions of Chapter 11 of the San Francisco Administrative Code and its franchise, except for those addressed by the Controller's Report, not less than every two years.	SFPUC	The SFPUC will comply with its statutory requirement to file a report with the Board as required in Chapter 11 of the San Francisco Administrative Code.

ATTACHMENT B: PG&E'S RESPONSE



*Pacific Gas and
Electric Company*

77 Beale Street
P.O. Box 770000
San Francisco, CA 94177
415 973 7000

October 26, 2009

Tonia Lediju, Director of Audits
City Hall, Room 476
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

RE: Audit of PG&E's Franchise Fees for 2006 through 2008

Dear Ms. Lediju:

Thank you for providing PG&E with an opportunity to comment on your draft report on the audit of PG&E's franchise payments for 2006, 2007 and 2008. We are pleased to see you have noted that PG&E submitted its franchise fees to the City on a timely basis and correctly collected and remitted electricity and gas franchise surcharge fees to the City.

We note that while you have found the change in methodology of allocating gross receipts for services under the Hetch Hetchy Interconnection Agreement was adequate, you have raised a question concerning whether the revised allocation methodology should be applied to receipts reported prior to 2005 and are seeking the advice of the City Attorney. Should the City Attorney's opinion identify concerns about PG&E's franchise fee reporting obligations, please advise us immediately.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Cecilia G.' with a stylized flourish at the end.

Cecilia Guiman
Manager, Revenue & Statistics

